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PLR-126400-10

Date:

September 28, 2010

LEGEND:

Distributing =

Controlled =

State A =

BusinessA =

BusinessB =

ItemA =

ItemB =

PeriodA =

DateA =

PropertyA =

PropertyB =
PropertyC =

PropertyD =

ShareholderM =

ShareholderD =

e =

f =

Dear

This letter responds to your representative's letter of 21 June 2010 requesting rulings as to the Federal income tax consequences of proposed transactions. The material information submitted in that letter and subsequent correspondence is summarized below.

The rulings contained in this letter are based upon facts and representations that were submitted on behalf of the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

In particular, this office has not reviewed any information pertaining to, and has made no determination regarding: (i) whether the distribution described below satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations; (ii) whether the distribution is used principally as a device for the distribution of the earnings and profits of the distributing company or the controlled company or both (see § 355(a)(1)(B) of the Internal Revenue Code and § 1.355-2(d) of the regulations); and (iii) whether this distribution is part of a plan (or a series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a fifty percent (50%) or greater interest in Distributing or Controlled (see § 355(e) of the Code and § 1.355-7 of the regulations). In addition, no opinion is expressed as to the tax consequences of any matter other than Step (I), Step (II), and Step (III) of the Proposed Transactions, below. Furthermore, other than as stated in the

rulings below, no opinion is expressed as to the validity of any subchapter S election of either Distributing or Controlled.

SUMMARY OF FACTS

Distributing is a StateA corporation that uses the cash method of accounting and a calendar year. Distributing is a subchapter C corporation but, as part of the proposed transactions described herein, Distributing will elect to be treated as a subchapter S corporation for Federal income tax purposes. Distributing is engaged in BusinessA and BusinessB, and has been engaged in BusinessA for many years. Distributing has outstanding e shares of common stock (and no other stock), all of which stock is held 50 percent by ShareholderM and 50 percent by ShareholderD. Both shareholders contribute to the management of Distributing and its businesses.

Distributing will form Controlled as a StateA corporation. Controlled will elect to be treated as an S corporation for Federal income tax purposes. Controlled will use the cash method of accounting and a calendar year. Controlled will have outstanding one class of stock which, initially, will all be held by Distributing.

Corporate Separation. To facilitate one or more corporate business purposes, ShareholderM and ShareholderD propose to each operate his own separate corporation. This is intended to enable each entity to focus on its own coherent business strategy. To achieve this separation, Distributing will transfer half of its assets and certain liabilities to Controlled in exchange for all the stock in Controlled and then will distribute all the Controlled Stock to ShareholderM. Controlled will receive approximately half of the assets associated with BusinessA and half of the assets associated with BusinessB.

Distributing Financial Information. Financial statements and other information submitted by Distributing indicate that Distributing's BusinessA has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past 5 years, with one exception. The exception is PeriodA, when Distributing engaged in limited BusinessA activity due to a temporary significant increase in the cost of supplies necessary to conduct BusinessA.

TRANSACTIONS BETWEEN SHAREHOLDERS

Shareholder Property Exchanges. In order to facilitate separate operations, it is anticipated that ShareholderM and ShareholderD will engage in one (or possibly more) exchanges of property with each other. ShareholderM will exchange his undivided one-half interest in PropertyA for the undivided one-half interest in PropertyB that is held by ShareholderD.

TRANSACTIONS INVOLVING DISTRIBUTING (BUT NOT CONTROLLED)

In order to have funds to facilitate the proposed corporate separation, Distributing may borrow funds from a bank or other unrelated party prior to The Proposed Transactions described below.

THE PROPOSED TRANSACTIONS FOR DISTRIBUTING AND CONTROLLED: THE CONTRIBUTION, DISTRIBUTION, AND S ELECTIONS

Step (I). The Contribution. Distributing will form Controlled. Controlled will have one class of common stock authorized. Distributing will transfer to Controlled approximately one half of the assets of both BusinessA and BusinessB (including real property and equipment) and certain liabilities associated with BusinessesA&B. In exchange, Distributing will receive all of Controlled's outstanding stock. It is probable that PropertyC will be included in the assets transferred to Controlled. Also, it is probable that the assets transferred will include property for which an investment tax credit was taken in prior years. To equalize values: (i) cash or other assets may also be transferred to Controlled; and (ii) the amount of liabilities assumed by Controlled or associated with the transferred assets may be more or less than one-half of Distributing's liabilities.

Step (II). The Distribution. Distributing will distribute to ShareholderM all of the Controlled Stock in exchange for all of ShareholderM's Distributing Stock.

Step (III). The S Elections. Controlled will make an election under § 1362(a) to be treated as a subchapter S corporation for Federal income tax purposes effective immediately following The Distribution. Distributing will make an election to be treated as a subchapter S corporation for Federal income tax purposes effective January 1, 2011.

TRANSACTIONS INVOLVING CONTROLLED (BUT NOT DISTRIBUTING)

Following the Proposed Transactions, above, it is probable that Controlled will rent PropertyC to ShareholderD.

RESULT OF TRANSACTIONS

Following the above transactions, it is anticipated that ShareholderM and ShareholderD will hold the following property interests:

ShareholderD will own all the stock in Distributing and the entire ownership interest in PropertyA.

ShareholderM will own all the stock in Controlled and the entire ownership interest in PropertyB.

ShareholderM and ShareholderD will each continue to own an undivided half interest in PropertyD.

ShareholderD will rent PropertyC from Controlled.

REPRESENTATIONS

Distributing has made the following representations in connection with the Proposed Transactions:

Representations as to the Step (I) Contribution and the Step (II) Distribution.

(a) The Shareholder Property Exchange and the Property Rental are each being negotiated separately from all the other transactions described above. The Property Rental payments will be at fair market value and the terms of the Property Rental will be consistent with normal rental agreements for such property. None of the terms of the Step (I) Contribution or the Step (II) Distribution was in any way affected by the property values or other terms in either the Shareholder Property Exchange or the Property Rental or any other transaction.

(b) Except as described above, neither the Step (I) Contribution nor the Step (II) Distribution is related to, or part of a plan involving, any other transactions.

(c) There is no plan or intention for either Distributing or Controlled to issue any stock, except for the issuance of Controlled Stock as described in Step (I), above.

(d) None of the transactions described above will result: (i) in a situation in which one party recognizes income, but another party recognizes the deductions associated with such income; or (ii) in a situation where one party owns property, but another party recognizes the income or deductions associated with such property.

(e) Distributing, Controlled, and each of the shareholders will each pay his, her, or its own expenses incurred in connection with each of the above transactions.

(f) Distributing is not under the jurisdiction of a court in a title 11 or similar case within the meaning of § 368(a)(3)(A).

(g) The fair market value of the Controlled stock received by ShareholderM in The Distribution will be approximately equal to the fair market value of the Distributing stock surrendered by such shareholder in exchange therefor.

(h) No part of the stock in Controlled is being received by ShareholderM as a

creditor or employee, or in any capacity other than as a shareholder of Distributing.

(i) Distributing has directly owned and operated BusinessA for over five years. Distributing will not have either directly or indirectly acquired BusinessA during the five-year period prior to The Distribution.

(j) Except with regard to PeriodA, the 5 years of financial information submitted on behalf of BusinessA is representative of the present operations of BusinessA and there have been no substantial operational changes since the date of the last financial statements submitted for such business.

(k) The limited amount of BusinessA activity during PeriodA was the result of a significant raw material price increase. This raw material, ItemA, is essential to BusinessA and constitutes a major expense for BusinessA. At the start of PeriodA, the price of ItemA increased very significantly. In addition, publications projected that this ItemA price increase would continue for a significant part of the PeriodA business cycle. At the same time, however, there was no corresponding increase in the projected price of ItemB, the BusinessA finished product. This PeriodA increase in the price for ItemA without any corresponding increase in the price for ItemB is well documented. As a result of this ItemA price increase, Distributing's management believed that the full operation of BusinessA during PeriodA would result in Distributing incurring unacceptably high operating losses. Accordingly, at the start of PeriodA, Distributing's management decided to temporarily suspend most BusinessA operations.

(l) BusinessA has been operated by the family of ShareholdersD and M for over f years, a very substantial number of years. In the years before the pre-Distribution 5-year period, there have been several other periods where management suspended much of BusinessA's active operations due to a rapid rise in raw material costs and other adverse circumstances. However, once these adverse circumstances were overcome, BusinessA resumed full active operation.

(m) During the 5-year period immediately prior to The Distribution, Distributing management never, at any time, had any intent for Distributing to permanently cease being engaged in BusinessA.

(n) Following the Step (II) Distribution, Distributing and Controlled will each continue independently and with its own separate employees (including its officers and shareholders acting on its behalf) to be directly engaged in the active conduct of its BusinessA.

(o) The Distribution is carried out for the corporate business purpose of enabling Distributing and Controlled to each focus on its own coherent business strategy with ShareholderM and ShareholderD each concentrating on his own separate

business. The Distribution is motivated in whole or substantial part by one or more of these corporate business purposes.

(p) The Distribution will not be used principally as a device for the distribution of earnings and profits of Distributing or Controlled or of both Distributing and Controlled.

(q) Before and immediately after the Distribution, Distributing will have outstanding solely a single class of common stock and Controlled will have outstanding solely a single class of common stock. At the time of The Proposed Transactions, neither Distributing nor Controlled will have outstanding any debt or convertible securities, warrants or options, or any other type of right or instrument, where such right or instrument constitutes an equity interest in Distributing or Controlled, or where pursuant to such right or instrument any person could acquire an equity interest in Distributing or Controlled.

(r) It is probable that Distributing will transfer to Controlled some assets that serve as security for a loan that was made to ShareholderM on DateA. Distributing is not liable for payment of this loan. The liability for this loan will not be assumed by Controlled. ShareholderM represents that: (i) he personally will be responsible for all payments on this loan; and (ii) that in no event will this loan be paid by Controlled.

(s) With regard to the assets transferred from Distributing to Controlled, both (i) the total adjusted basis of such assets and (ii) the total fair market value of such assets will each equal or exceed the sum of the liabilities (as determined under § 357(d)) assumed by Controlled.

(t) All of the liabilities of Distributing assumed by Controlled (as determined under § 357(d)) were incurred in the ordinary course of business and are associated with the assets transferred.

(u) Distributing neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of The Proposed Transactions.

(v) Payments made in connection with all and any continuing transactions between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(w) Neither Distributing nor Controlled is, or will be, an investment company as defined in § 368(a)(2)(F)(iii) and (iv).

(x) The Distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a fifty-percent (50%) or greater interest (within

the meaning of § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation). It is planned for ShareholderD to hold over 50 percent of the stock in Distributing and for ShareholderM to hold over 50 percent of the stock in Controlled.

(y) No intercorporate debt will exist between Distributing and Controlled (and there will be no indebtedness between Distributing and any entity directly or indirectly controlled by Controlled or between Controlled and any entity directly or indirectly controlled by Distributing).

(z) Neither Distributing nor Controlled will be a disqualified investment corporation within the meaning of § 355(g)(2). In addition, immediately following The Distribution no person will hold a 50 percent or greater interest (within the meaning of § 355(g)(3) and (d)(4)) in either Distributing or Controlled except for persons who held a 50 percent or greater interest prior to The Distribution.

(aa) Controlled will not transfer any assets to Distributing (except stock in Controlled).

(bb) With regard to the proposed transfer of investment tax credit property from Distributing to Controlled (and with regard to the transfer of any other “investment credit property,” or similar property) all required adjustments will be made so as to properly reflect the disposition, including any early disposition, of such property, in accord with § 50(a)(1) or (a)(2) and any other applicable provisions.

(cc) Immediately prior to The Distribution, each share of the outstanding stock in Distributing will have been held by its then current holder at all times during the 5-year period prior to The Distribution (except for any within-family transfers of stock as a result of a family member death).

(dd) There is no plan or commitment by Distributing or Controlled or by any of the shareholders for any shareholder to sell, exchange, transfer by gift, redeem or otherwise dispose of any of the stock in Distributing or Controlled (except as described in The Proposed Transactions). Subsequent to The Distribution, it is not expected that there will be any change in any shareholder’s holding of stock in Distributing or Controlled.

(ee) Distributing uses, and Controlled will use, the cash method of accounting.

(ff) There is no plan or intention: (i) to liquidate either Distributing or Controlled; (ii) to merge either Distributing or Controlled with any other corporation; or (iii) to sell or otherwise dispose of the assets of either Distributing or Controlled subsequent to The Distribution (except for dispositions described above in The Proposed Transactions and dispositions of assets in the ordinary course of business).

(gg) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary or related entity, to purchase any of its outstanding stock (or other equity interests) after The Distribution, other than through purchases meeting the requirements of Section 4.05(1)(b) of Rev. Proc. 96-30.

(hh) The Distribution is not intended to, or expected to, result in a reduction in the total amount of Federal income tax payable by Distributing and its successors. That is, the total amount of Federal income tax payable after The Distribution by Distributing and Controlled is anticipated to be no less than the amount that would be payable by Distributing if The Distribution did not occur. As a result of the Step (III) S Elections, the income of Distributing and Controlled will flow through to their shareholders. Thus, the S Elections will result in changes in the tax payable. However, absent the S Elections, it is anticipated that The Distribution would not result in any decrease in the total amount of Federal income tax payable.

Representations as to the Step (III) S Elections.

(ii) On the effective date of Distributing's S corporation election, Distributing will be eligible to elect S corporation status pursuant to §1362(a).

(jj) Immediately after the Step (II) Distribution, Controlled will be eligible to elect S corporation status pursuant to §1362(a).

(kk) Controlled will elect to be treated as an S corporation, effective immediately after The Distribution.

(ll) None of the persons holding stock, membership interests, or any equity interest in either Distributing or Controlled is a nonresident alien individual, a foreign corporation, or a trust (except for trusts meeting the requirements of §1361(c)(2)).

(mm) There is no plan or intention to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.

(nn) Distributing does not use the LIFO method for inventory.

RULINGS

Based solely on the information submitted and the representations set forth above, we rule as follows:

Rulings with regard to the Step (I) Contribution and the Step (II) Distribution

(1) The transfer of assets from Distributing to Controlled in The Contribution followed by The Distribution will constitute a reorganization within the meaning of

§ 368(a)(1)(D). Distributing and Controlled will each be a "party to a reorganization" within the meaning of § 368(b).

(2) No gain or loss will be recognized by Distributing upon the transfer of assets to Controlled in exchange for stock in Controlled and the assumption of liabilities of Distributing by Controlled in The Contribution (§§ 361(a) and 357(a)).

(3) No gain or loss will be recognized by Controlled on The Contribution (§ 1032(a)).

(4) The basis of each asset received by Controlled will be determined in accordance with § 362(b) and § 362(e).

(5) The holding period for each of the assets received by Controlled will include the period during which such asset was held by Distributing (§ 1223(2)).

(6) No gain or loss will be recognized by Distributing upon the distribution to ShareholderM of Controlled stock in The Distribution, as described above (§ 361(c)(1)).

(7) No gain or loss will be recognized by (and no amount will be included in the income of) ShareholderM upon receipt of Controlled stock in The Distribution (§ 355(a)(1)).

(8) For ShareholderM, immediately after The Distribution, the shareholder's basis in the Controlled stock received will be the same as the basis of the Distributing stock surrendered by ShareholderM in exchange therefor (§ 358(a)(1)).

(9) For ShareholderM, the holding period of the Controlled stock will include the holding period of the Distributing stock exchanged therefor, provided that the Distributing stock is held as a capital asset in the hands of such shareholder on the date of the exchange (§ 1223(1)).

(10) As provided in § 312(h) of the Code, the proper allocation of earnings and profits among Distributing and Controlled will be made under § 1.312-10(a).

Rulings with regard to Step (III), The S Elections by Controlled and Distributing

(11) Provided that The Distribution is undertaken immediately after The Contribution, Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under § 368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under § 1361(b)(1)(B) and will not, in itself, render Controlled ineligible to elect to be an S corporation for its first taxable year. If Controlled otherwise meets the requirements of a small business corporation under

§ 1361, Controlled will be eligible to elect to be a subchapter S corporation under § 1362(a) for its first taxable year.

(12) Controlled will be subject to the built-in gain provisions of § 1374 with respect to the assets transferred from Distributing to Controlled. Upon becoming a subchapter S corporation, Distributing will be subject to the built-in gain provisions of § 1374 with respect to its retained assets. See § 1374(d)(8).

CAVEATS

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any matter or item discussed or referenced in this letter. Moreover, no opinion is expressed about the tax treatment of the transactions (or of any other matter) under other provisions of the Code or regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions not specifically covered by the above rulings.

In particular (as provided above), no opinion is expressed regarding: (I) whether The Distribution satisfies the business purpose requirement of § 1.355-2(b); (II) whether The Distribution is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see § 355(a)(1)(B) of the Code and § 1.335-2(d) of the regulations); and (III) whether The Distribution is part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii).

In addition, except to the extent specifically provided in the rulings above, no opinion is expressed as to: (I) the validity of any S corporation election of either Distributing or Controlled; (II) whether either Distributing or Controlled is eligible to be taxed as an S corporation; and (III) whether Distributing and Controlled's elections to be an S corporation will be valid.

PROCEDURAL STATEMENTS

This private letter ruling is directed only to the taxpayers who requested it. Section 6110(k)(3) of the Code provides that this private letter ruling may not be used or cited as precedent.

It is important that a copy of this letter be attached to the Federal income tax returns of each taxpayer involved for the taxable year(s) in which the transactions are consummated. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching to the return a statement that provides the date and control number (PLR-126400-10) of this ruling letter.

Pursuant to the power of attorney on file in this matter, a copy of this letter is being sent to your authorized representative.

Sincerely,

Marlene P. Oppenheim
Marlene P. Oppenheim
Senior Counsel, Branch 5
Office of Associate Chief Counsel
(Corporate)

cc: